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Third-country equivalence: a Brexit scenario for UK financial services

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*I.C.C.L.R. 1 Abstract

This article analyses one among possible means of facilitating the supply of financial services from the UK into the Member States of the EU and the European Economic Area (EEA*), post-Brexit. It sets out the legal framework and the relevant EU authorities that determine third-country equivalence.*

Introduction

The importance and value of banking and the financial services and investment industry to the British economy as measured by any metric (GDP, tax receipts, trade balance, inward investment, direct and indirect employment etc) needs no restatement. The credit crunch and the global financial crisis commencing in 2007–08 threatened the primacy and formerly more affirmative attitudes held towards financial services in British society[1]; the economic crisis also produced changes in the regulatory approach taken by relevant authorities: principally the Prudential Regulatory Authority (PRA), the Financial Conduct Authority (FCA)[2] and the Bank of England (BoE). A qualitatively distinctive and a historically unprecedented challenge arose with the referendum in June 2016 and the consequent planned departure of the UK from the EU.[3]

The proliferation of speech and writing about Brexit focuses on the larger question of the negotiation underway between UK and EU representatives and the politically fraught question of Britain's relationship with the single market and the "divorce" and terms for the relationship after March 2019. Within the literature specific to financial services, some analyses have considered a particular arrangement under which the UK leaves the single market but preserves a preferential (in some sense) ability to offer financial services in the EU/EEA.[4] One ***I.C.C.L.R. 2** such arrangement is the subject of this article: third-country equivalence.[5] That is: an EU determination that the UK (as a third country—vis-à-vis the EU) is one whose regulations in relation to some specified subset of financial services are equivalent to those of EU law, and which would therefore not incur compliance burdens (beyond those imposed by the relevant UK authorities) in order to operate and offer financial and investment services in the EU/EEA.

The current position—comprehensive EU/EEA passporting

The legal position in general at present, pre-Brexit, is that companies and financial institutions authorised by the relevant authorities of their home state (where the home state is an EU/EEA country), including those of the UK, may supply financial services in any other EU/EEA state without the necessity of seeking authorisation from the financial service regulators in the host state. The legal basis for this position is composed of a variety of EU directives[6] under which financial institutions may apply for a "passport" with which the services they offer can effectively travel to the other EU/EEA states.[7] The European passport, or (synonymously) the single licence, embodies the European Commission's (EC's) approach to harmonisation of regulations in relation to financial services[8] and is a key component of the programme of harmonisation agreed and undertaken by the EU/EEA states.[9] The home country retains regulatory control, which is at most ***I.C.C.L.R. 3** supplemented by minimal or light-touch regulation of the host state.[10] Effectively, a financial company offers its services in another state, just as a trading company could offer goods under the single market without encountering tariff or non-tariff barriers. Although this position is common to all EU/EEA states, and therefore applicable to all EU/EEA states other than the UK seeking to supply financial services in the UK (inbound financial services), the principal concern of this article is outbound financial services: those emanating from the UK into another EU/EEA state or states.

Eliding a topic area of some speculation and argument, this article operates on the assumption that more likely than not the UK will leave the single market; this appears the most probable outcome at time of writing.[11] Whether or not there is an interim or transitional period, and irrespective of the duration of any such interval, this article assumes that, following the departure of the UK from the EU, EU/EEA states will retain the current right to passport financial services while the UK will lose this right.[12] Therefore, the question that this article seeks to answer is: under what terms may outward financial services be supplied by UK-based financial institutions into the EU/EEA states post-Brexit? In answering that question the article offers an examination of one possible solution: third-country equivalence.[13]

The implications of Brexit for UK-based financial services

Figures estimating impact of Brexit by scenario are available, although they must be treated with caution. For example, a "'low access' post-Brexit scenario has been estimated to result in a loss of £18–20 billion in revenues".[14] The value and reliability of such broad and necessarily highly speculative measures is certainly open to question and at any rate finer-grained measures are required regarding financial services. Although not indicative of assets, examining the number of passports offers a picture of their current importance both inbound into the UK and outbound from the UK into other EU/EEA states. There are a total of 359,953 (inbound number 23,532 and outbound 336,421)[15]; these figures suggest that the ***I.C.C.L.R. 4** passport has been more important for companies whose home state is the UK, seeking to trade in the other EEA states, and that therefore the loss of passporting will affect UK financial services more severely than their EU/EEA competitors and counterparts post-Brexit.

However, complicating this analysis slightly, a larger number of firms (8,008) have applied for inbound passports than those UK-based firms seeking outbound passports (5,476).[16] Even without an examination of asset values, this pair of figures combined with that in the previous paragraph produces the conclusion that UK-based firms are applying for more passports in absolute terms and per firm than those other EU (and EEA) states seeking to export financial services to the UK. Although the provision of financial services is not a zero sum game and the UK has developed its own specialisms and comparative advantage—for example, in OTC derivatives, (re)insurance, currency and certain commodity markets—these figures nevertheless highlight the importance for the British economy of a viable alternative arrangement that will at least go some distance to replace the rights to passport that have been enjoyed by UK-based financial institutions.

The operative assumption of this article is that those UK firms that do not open a branch in an(other) EU/EEA Member State and operate under that state's regulatory oversight (with the heightened compliance costs entailed thereby) will lose the right to offer financial services in that or other EU/EEA state(s) because they will lose the right to passport. However, it is not possible to quantify the measure of financial and business loss in this sector without knowing what alternative arrangements may be put in place. The remainder of the article will consider one legal basis (in the next section) under which the status quo ante (i.e. the present and pre-Brexit position) could, in theory, be maintained subject to the qualifications, caveats and practical difficulties attendant upon it. The purpose of this article is to introduce some analytical clarity about third-country equivalence and not to make policy proposals or normative arguments about this or any other alternative terms of UK–EU engagement post-Brexit.

Third-country equivalence—legal tests and procedure

The legal test

As a doctrine of financial services law, third-country equivalence has existed for about three decades and was designed to "facilitate cross border trading between markets that choose to recognise one another's standards"; among the earliest arrangements was one agreed in the1990s "between the UK and US covering mutual access to derivatives markets".[17] This article's concern narrows to third-country equivalence as that concept has been elaborated, codified and institutionalised in the EU/EEA. ***I.C.C.L.R. 5***

The legal basis for third-country equivalence is set out in the Markets in Financial Instruments Regulation (MiFIR) arts 46 – 48.[18] Post-Brexit, the issue of equivalency would not arise where a UK-based financial institution opens a branch in the EU 27 or in an EEA Member State.[19] In addition, it would not arise if the institution were offering investment services exclusively to "eligible counterparties to professional clients".[20] In order for a firm to operate under third-country equivalency, the firm must be authorised in the jurisdiction where its head office is located (art.46(2)(b)) where it must be "subject to effective supervision and enforcement ensuring a full compliance with the requirements applicable in that third country". Article 46(2)(c) requires co-operation arrangements between the authorising state and the EU to have been established.[21]

If these tests of the firm and the home state of the firm are satisfied, then under art.46(3) "member states cannot impose any additional requirements on the third country in relation to matters covered". The functional result then is the same from the standpoint of the firm as if it were operating under a passport and the (notionally) *ancien regime*. However, in the countervailing direction under the MiFIR, EU Member States cannot treat the equivalent firm "more favourably than union firms".[22] This is a significant provision and resonates with the broader strategic logic that it would not be in the EU interest if third parties could be treated more favourably than members; to do so would create an incentive for defection and it would also undermine the reasons for the harmonisation and integration essential to the single market. This provision also highlights that third-country equivalence is (notwithstanding the functional similarity) a subordinate, lesser and alternative form of integration and co-operation as compared with EU/EEA membership and passporting.[23]

The power to decide whether a country will receive, in a particular area of financial services, the status of equivalence rests with the EC, under art.47.[24] Third-country equivalence is there defined to mean

"that the legal and supervisory arrangements of that third country ensure that firms authorised in that third country comply with legally binding prudential and business conduct requirements which have equivalent effect to the requirements". ***I.C.C.L.R. 6*** [25]

The equivalency then is measured in terms of its effect, as opposed to—for example—the substance, procedural or technical approach inherent in the regulations themselves.[26]

Article 47(1) sets out the key test for equivalency, which is applied to the "the prudential and business conduct framework" of non-EU/EEA states. This framework must meet each of the following conditions: (1) be "subject to authorisation and to effective supervision and enforcement on an on-going basis"; (2) "sufficient capital requirements and appropriate requirements applicable to shareholders and members of their management body"; (3) "adequate organisational requirements in the area of internal control functions"; (4) subject to "appropriate conduct of business rules"; and (5) "ensures market transparency and integrity by preventing market abuse in the form of insider dealing and market manipulation". Co-operative arrangements between the EU (the European Securities and Markets Authority—ESMA) and the third country's authorities are provided for, as are "information exchange, notification and procedures for coordination".[27]

It should be carefully observed that although the object of scrutiny in ascertaining equivalence is the third country and its regulations, the direct beneficiary of equivalence is individual financial institutions and firms, with any benefit redounding to their home country being indirect (for example, through tax receipts and employment). However, there is an asymmetry in that the actions or omissions of a *firm* could result in the *country* losing third-country equivalency. In terms of evidentiary requirements, there is no legal bar to a decision that a country's regulatory apparatus is not equivalent that is based purely on the conduct of a single firm, as such conduct could be construed as prima facie evidence of its home country's regulatory inadequacy. The fragility of third-country equivalency and the position of any country applying for it is thereby evident; it will be further considered below.

Provided a third country achieves equivalence as decided by the EU (subject to the procedures set out in the next section), this fact is recorded on a register. The register reflects 39 distinct equivalence areas, grouped under 14 different pieces of EU financial services legislation.[28] While these figures suggest that the areas in which there is an existing legal basis for a finding of equivalence are extensive,[29] they do not exhaust the areas of investment and financial services and activities in which

UK-based firms currently (or may in the future) seek to operate. ***I.C.C.L.R. 7***

The institutional application of the legal test

The decision whether or not to grant a country equivalent status is made by a vote of the EU Member States, in the European Parliament. However, the EC has considerable powers of proposal and initiative in making recommendations to the Parliament when it puts its recommendation to a vote of the Member States. The EC has limited scope to act without Member State approval; for

"financial services legislation, the European Commission has a limited ability to adopt a decision that is not approved of by member states, unless delaying adoption of a decision would create a risk to the financial interests of the EU as a result of fraud or other illegal activities".[30]

The EC[31] takes the technical advice of its Directorate General for Financial Services; this advice is based upon recommendations, data and analysis supplied by the three cross-EU supervisory authorities: the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA).[32] According to the EC's explanation of the process, the ESMA scrutinises the third country and, together with the EC, the two bodies assess

"whether the rules of the authority in the third country achieve the same objectives as the EU, i.e. a robust CCP [Central Counterparties] framework promoting financial stability through a reduction in systemic risk".[33]

If the decision is positive, it is implemented in a "legally binding implementing act in accordance with Article 25(6) of the European Market Infrastructure Regulation (EMIR) (Regulation (EU) No 648/2012) ". ***I.C.C.L.R. 8*** [34]

Analysing third-country equivalence

Examples of third countries granted equivalency status

Thirty-five countries have received an equivalency status in at least one area of financial services.[35] In the EU's publication of the roster of these countries, two additional countries (Israel and Chile) are listed, presumably as they have applied for equivalency status. Several countries have attained only one equivalency: Mauritius, Egypt, Russia, the Caymans and Abu Dhabi (not a country but an emirate in the federal United Arab Emirates—UAE). Another UAE emirate, Dubai (which is footnoted as Dubai International Financial Centre—DIFC), has three. The highest in number are the US and Canada, which have 16 each.

The limits of equivalency

While an EC finding of equivalency is not a limitation but an opportunity for non-EU/EEA countries such as those referenced immediately above, from the standpoint of a present but soon to be former member of the EU (i.e. the UK), third-country equivalence appears to be a limited option owing to the base-line comparison of passporting under the single market and as an EU Member State. This section examines these limitations as compared with the present position and the right to passporting integral to it.

The discretion of the EC in finding (and formulating the terms of) third-country equivalence in relation to the post-Brexit UK is wide. A finding of third-country equivalence can be conditional or limited in time; it may be revoked or suspended essentially at will, without any avenue of appeal. The fact that, at the moment the UK ceases to be an EU Member State, each entity will share identical regulatory frameworks suggests that a finding of equivalence would be apposite and arguable at that time. However, such an observation does not bind the EC even if it may rationally be in the best interests of both the UK and the EU—at least when financial services are considered in isolation. Post-Brexit changes to the EU regulation of financial services, however, could gradually alter this opening position, and the UK would not be a party to the processes and discussions leading to the underlying legislative and regulatory changes.

If the EU decided to "'gold plate' … standards in ways that the UK does not wish to follow",[36] the UK would no longer have a defensible claim to being deemed equivalent, necessitating either doing without equivalence or acquiescing to the form of gold plating or other regulatory change adopted by the EU. The corollary of this scenario, one in which the UK sought to achieve "super equivalence", is also conceivable but even then a finding of equivalence would be a privilege and not a right.[37] In short, there is no certainty or assurance that the relevant UK ***I.C.C.L.R. 9** authorities will continue to maintain a standard that is and is found by the EC and its advisory authorities to satisfy the legal tests for third-country equivalence.

Even if the UK were to secure equivalency in each of the areas in which it has been awarded (which no country has done to date),[38] in order to maintain the status quo ante Brexit, it would be necessary for the EC to add new areas of equivalence, not among the 39 already extant.[39] There is no legal reason why novel areas could not be created de novo, although this would surely not happen quickly owing in no small measure to political considerations. A further practical issue is that there is no legal obligation regarding the time within which a decision must be made regarding an equivalence application.[40]

In a further distinction between passporting and equivalence, art.49 of the MiFIR gives the ESMA the power to withdraw registration of an equivalency finding, implying that on a continuing and indefinite basis equivalency is conditional and discretionary. Importantly, such deregistration expressly could occur on the basis of the conduct of a firm, not of the regulatory authorities of a country where: "the third country firm is acting in a manner which is clearly prejudicial to the interests of investors or the orderly functioning of markets"; the "firm has seriously infringed the provisions applicable to it in the third country and on the basis of which the Commission has adopted the Decision"[41]; or the ESMA has

"referred the matter to the competent authority of the third country and that third-country competent authority has not taken the appropriate measures needed to protect investors and the proper functioning of the markets in the Union or has failed to demonstrate that the third-country firm concerned complies with the requirements applicable to it in the third country".[42]

The only duty incumbent upon the ESMA is to give at least 30 days' notice before withdrawing the equivalence.[43] However highly firms or countries rate the probability of a change in status, the art.49 MiFIR provisions introduce uncertainty and an additional challenge and complexity to business development and corporate strategic planning, with what would very likely be manifestly insufficient notice to change course or re-direct assets and resources. At the same time, however, the provision and availing of financial services in those significant areas in which the ***I.C.C.L.R. 10** UK has found or developed comparative advantage weighs with some force not only on the UK as offeror but also upon EU market participants as offeree.[44]

Conclusion—considerations attendant on the larger Brexit process

As one element of a multi-faceted and an unprecedented historical process, the issue of equivalence or alternative terms upon which financial services may be offered by UK-based institutions and companies into the EU/EEA post-Brexit cannot be viewed in isolation. While, as asserted at the outset of this article, banking and financial services are of substantial national importance in Britain, neither this nor any single factor is of infinite weight in the calculations of the British Government and its agents tasked with the ongoing negotiations. One suggestion is that beginning to establish third-country equivalence, or more realistically setting the groundwork for doing so, should be part of the Brexit negotiations,[45] with a precedent of such a "pre-emptive" equivalence being the Solvency II Directive [46] for insurance.[47] However, equivalence as provided for under arts 46 – 48 of the MiFID cannot be achieved until the UK actually becomes a third country: that is, until it has formally ceased to be an EU Member State[48] under art.50 TFEU.

Another suggestion is that an enhanced version of equivalence (or "equivalence plus"), in which UK sectors not currently considered for equivalence by the EC could be deemed equivalent under newly created categories,[49] addressing the issue noted above that equivalence has never ranged across the entire spectrum of financial services and cannot therefore be a fully adequate substitute for passporting. As also observed above, as preparatory action to equivalence, or for that matter for equivalence-plus, co-operation agreements would be a necessary precondition; this might be the UK's thin edge of the wedge in relation to the Brexit negotiation.

Some observers argue that equivalence, at least across existing dimensions, is rendered somewhat realistic and in any case nominally more feasible owing to new EU securities regulations (MiFID II)[50] which come into force in January 2018.[51] Of course, what may make at least an emergent third-country equivalence more probable for the UK would be concessions in other areas of negotiations, whether ***I.C.C.L.R. 11*** in relation to trade or movement of persons, or some other facet or combination of issues arising in the negotiation, including the possibility of UK contributions to the EU budget post-Brexit. British domestic politics may be a limiting or an enabling factor. As noted in the introduction, the sympathies of the population at large for bankers and the financial services sector are by no means running high at this point in time so there may be continued resistance to sacrifices in other areas—as well as against greater UK payments: an upfront and very visible cost, for a deferred benefit, and a benefit that the majority of the British electorate is unlikely to rate very highly, whether rightly or wrongly.

This article compared the status quo ante Brexit, under which financial institutions whose home state is the UK may offer investment and financial services in the EU/EEA (without having opened a branch in another EU member or in an EEA state) and the use of and powers afforded to these financial institutions by a passport, with third-country equivalency. It set out the legal tests for third-country equivalence and the institutional decision procedures under which a status of equivalence is awarded (or denied) and an illustrative sampling of the countries to which the status of equivalence have been granted by the EU.

The areas of financial and investment services that have been deemed equivalent by the pertinent EU authorities were set out and illustrated. This has led inexorably to the conclusion that, while these are wide-ranging, there are significant areas in which UK financial institutions currently rely upon passporting but which have not been areas where equivalences have been found by the EU with any third country. Some (arguably somewhat sanguine) Brexit scenarios suggest that these and other novel areas and directives could be negotiated as areas of potential and/or pre-emptive equivalency, subject to the necessary preliminary co-operation agreements being concluded between the UK and the EU authorities in the lead-up to and following the date upon which the UK ceases to be an EU Member State.

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1. British Values Survey quoted in the speech of Mark Carney (Governor of the BoE) at Thomson Reuters (7 April 2017), "The high road to a responsible, open financial system", fn.3: "The British Social Attitudes Survey (2013) reported that only 20% of UK citizens now think banks are well-run, down from 90% in the late 1980s."

2. The FCA and the PRA replaced the Financial Services Agency (FSA) in 2013.

3. The chain of events that led to the planning of Britain's relinquishing membership are also well known; in relation to this and an analysis of its implications for EU and UK financial services, see Pierre E. Berger and Olivier Van den Broeke, "Enter Brexit: What is the Impact on the Financial Services Industry?" [2017] I.C.C.L.R. 209. As these authors state (p.209): London "is the largest and most important financial centre of the EU … Brexit may have serious repercussions on the existing mutual relations between the UK, the EU and third countries".

4. The EEA (pre-Brexit) comprises the 28 EU Member States, plus Norway, Lichtenstein and Iceland. An example of this literature is John Armour, "Brexit and Financial Services" (2017) 33 Oxford Review of Economic Policy S54.

5. Armour, "Brexit and Financial Services" (2017) 33 Oxford Review of Economic Policy S54. Armour considers third-country equivalence at pp.S61–S68.

6. Fourth Capital Requirements Directive (Directive 2013/36 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87 and repealing Directives 2006/48 and 2006/49 [2013] OJ L176/338) (CRD IV); Capital Requirements Regulation (Regulation 575/2013 on prudential requirements for credit institutions and investment firms and amending Regulation 648/2012 [2013] OJ L176/1) (CRR); Markets in Financial Instruments Directive (Directive 2004/39 on markets in financial instruments amending Directives 85/611 and 93/6 and Directive 2000/12 and repealing Directive 93/22 [2004] OJ L145/1) (MiFID); forthcoming MiFID II Directive (Directive 2014/65 on markets in financial instruments and amending Directive 2002/92 and Directive 2011/61 [2014] OJ L173/349); Solvency II Directive (Directive 2009/138 on the taking-up and pursuit of the business of Insurance and Reinsurance [2009] OJ L335/1) (Solvency II); Insurance Mediation Directive (Directive 2002/92 on insurance mediation [2003] OJ L9/3); Insurance Distribution Directive (Directive 2016/97 on insurance

distribution (recast) [2016] OJ L26/19); Alternative Investment Fund Managers Directive (Directive 2011/61 on Alternative Investment Fund Managers and amending Directives 2003/41 and 2009/65 and Regulations 1060/2009 and 1095/2010 [2011] OJ L174/1); and UCITS IV Directive (Directive 2009/65 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities [2009] OJ L302/32).

7. *A. Hudson, The Law of Finance, 2nd edn (London: Sweet and Maxwell, 2013), para.28-25*: "The passporting policy … was adopted for the regulation of banking so that once a bank is authorised to act as such in its home Member State, then it will be able to establish branches to provide banking services in other Member States of the EU." In detailing the history of the passport at para.7-29, Hudson explains that it began with the market for securities; "once the competent authority in one jurisdiction has authorised an issue of securities or any other matter, then the issue of securities is deemed to have acquired a passport" which permitted "it to travel throughout the entire EU".

8. Preamble to the CRR Recital 7 (replacing Banking Consolidation Directive (Directive 2006/48 relating to the taking up and pursuit of the business of credit institutions (recast) [2006] OJ L177/1) Recital 7, replacing Second Banking Directive (Directive 89/646 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions and amending Directive 77/780 [1989] OJ L386/1), Recital 4 states that "it is appropriate to effect only the essential harmonisation necessary and sufficient to secure the mutual recognition of authorisation and of prudential supervision systems, making possible the granting of a single license recognised throughout the Community and the application of the principle of home Member State prudential supervision". In relation to passporting, see *Ellinger's Modern Banking Law, edited by E.P. Ellinger, Eva Lomnicka and C.V.M. Hare, 5th edn (London: Oxford University Press, 2011), pp.71–72*.

9. As *Hudson, The Law of Finance (2013)* indicates (para.7-29) passporting remains (at least as long as the UK is an EU Member State) "an important part of the policy established by the Market in Financial Instruments Directive (MiFID) in relation to regulatory approvals".

10. *E. Lomnicka, "The Home Country Control Principle in the Financial Services Directives and the Case Law" in M. Andenas and W.H. Roth (eds), Services and Free Movement in EU Law (Oxford: Oxford University Press, 2002), Ch.11, pp.295–320*.

11. Which is not to say that the most probable or the actual outcome could not change before March 2019.

12. *"Banks fear chill wind of EU 'passport' free", Financial Times, 21 September 2016.*This article includes a table quantifying the reliance of UK incorporated banks on the right to passport. In the following rank order and in a non-exhaustive list: Barclays (over £1 trillion); Lloyds and RBS (each in excess of £750 billion); followed by HSBC, Goldman Sachs and Standard Chartered.

13. This is only one of the possibilities in the at least logically possible range of relationships and terms for the offer of financial services. The European Commission, EU equivalence decisions in financial services policy: an assessment SWD(2017) 102, p.7 (available at: https://ec.europa.eu/info/files/eu-equivalence-decisions-financial-services-policy-assessment_pl [Accessed 28 November 2017]) outlines several others. First, national treatment (which is the US approach) under which "[f]oreign persons, entities, and products are generally treated in the same manner as domestic ones, and regardless of the foreign regulatory regime they should comply with the same requirements as imposed on domestic operators. As a result, there is no need for the domestic regulator to develop a detailed understanding of foreign regulatory regimes". Secondly, exemptions (as granted by Japan or Switzerland) "focus on selected regulatory aspects of cross-border activity of foreign firms. Some of these jurisdictions leave considerable discretion to supervisors and are in position to apply broad exemptions". Thirdly, international agreements—"such as EU-Switzerland Non-Life Insurance Agreement and the recently concluded EU-US Covered Agreement on Insurance and Re-insurance".

14. See the estimate from the *Oliver Wyman Consultancy from its publication "The Impact of the UK's Exit from the EU on the UK-based Financial Services Sector"* quoted in *Norton Rose Fulbright, "Examining Regulatory Equivalence" (12 January 2017), p.14*.

15. *House of Lords, European Union Committee, Brexit: financial services: 9th Report of Session 2016–2017 (15 December 2016), para.17*; see Table 1 figures supplied by the FCA at p.3 of the subsequently cited letter. Also see *"Letter from Andrew Bailey to Andrew Tyrie MP, Chair of the House of Commons Treasury Select Committee" (17 August 2016)* available at: https://www.parliament.uk/documents/commons-committees/treasury/Correspondence/AJB-to-Andrew-Tyrie-Passporting.PDF [Accessed 10 November 2017]; Table 2 breaks passports down by directive (found at p.4 of this letter).

16. See preceding footnote.

17. *J. Ford, "Financial Future after Brexit: passporting v equivalence", Financial Times, 12 January 2017*.

18. MiFIR (Regulation 600/2014 on markets in financial instruments and amending Regulation 648/2012 [2014] OJ L173/84) arts 46 –48 Title VIII: "Provision of Services and Performance of Activities by Third Country Firms following an equivalence decision with or without a branch". All references to articles and sections in this part of the article are to the MiFIR.

19. Provided that it is registered in the register of third-country firms kept by the European Securities and Markets Authority (ESMA)—MiFIR art.46(1).

20. MiFIR art.46(1) –(2).

21. Pursuant to MiFIR art.47(2).

22. MiFIR arts 46(3) – (4) set out the details for application, disclosure and the timeline for these (without requiring the relevant authorities to decide an application within any particular period of time).

23. A further Brexit scenario (beyond the scope of this article) under which the UK left the EU but joined the EEA would render third-country equivalency inapplicable.

24. Referring to the procedure in MiFIR art.51(2).

25. Continuing: "set out in this Regulation, in Directive 2013/36/EU and in Directive 2014/65/EU and in the implementing measures adopted under this Regulation and under those Directives and that the legal framework of that third country provides for an effective equivalent system for the recognition of investment firms authorised under third-country legal regimes" (MiFIR art.47).

26. "The implementation of these provisions involves in many cases an outcomes-based process. It is the equivalence of regulatory and supervisory results that is being assessed, not a word-for-word sameness of legal texts. In general, these last seven years, the EU has carried out significant work on equivalence, also reflecting the interest in facilitating cross-border regulation and provision of financial services"—European Commission, EU equivalence decisions in financial services policy: an assessment SWD(2017) 102, p.4.

27. MiFIR art.47(2).

28. MiFIR art.48. For a discussion, see *Norton Rose Fulbright, "Examining Regulatory Equivalence" (2017), Appendix A, p.49*. See also *H. Evans, Evidence on "Brexit and Financial Services", addressed to the House of Lords, Select Committee on the European Union Financial Affairs Sub-Committee (12 October 2016)*.

29. Those directives and regulations where equivalency can be granted include: cross-border provision of investment services to wholesale clients or counterparties (MiFID II /MiFIR); permitted execution venue for shares and OTC derivatives subject to trading mandate (MiFID II /MiFIR); non-discriminatory access to trading venues, CCPs (central counterparties) and benchmarks (MiFID II /MiFIR); the establishment of CCPs and trade repositories (European Market Infrastructure Regulation—Regulation 648/2012 on OTC derivatives, central counterparties and trade repositories [2012] OJ L201/1 (EMIR)); Marketing of Alternative Investment Funds (AIFMD); reinsurance (Solvency II). Those not covered include: lending and deposit-taking, pursuant to CRD IV; retail asset management; payment systems; and retail services under MiFID and MiFIR. Source: *House of Lords, "European Union" (15 December 2016), Ch.3: The impact of the loss of passporting, paras 40–43*.

30. *Shearman & Sterling client publication, "Brexit and Equivalence: Review of the Financial Services Framework Across All Sectors" (10 August 2016), p.1*.

31. The Commission is empowered "with involvement of other institutions to decide on the equivalence of foreign rules and supervision for EU regulatory purposes": *Norton Rose Fulbright, "Examining Regulatory Equivalence" (2017), Appendix A, p.49*.

32. *Openeurope.org, "What is equivalence?"* available at: http://openeurope.org.uk/today/blog/understanding-regulatory-equivalence-an-effective-fall-back-option-for-uk-financial-services-after-brexit/. EBA webpage available at: https://www.eba.europa.eu; ESMA webpage available at: https://www.esma.europa.eu; EIOPA webpage available at: https://eiopa.europa.eu [All accessed 2 November 2017]. *N. Moloney, House of Commons Economy Committee, "The Impact of the EU Exit on Financial Services" (11 October 2016)* which states: "Yet ironically, this fear of politicization likely under-appreciates the merits of leaving decisions to technocrats, which is precisely what the democratically opaque structure of the Commission, and *a fortiori* the delegation of the initial assessment to the European Supervisory Authorities (ESAs), is intended to achieve."

33. EC, Press Release, "European Commission adopts equivalence decisions for CCPs and trading venues in ten non-EU jurisdictions" (16 December 2016). The EU rationale for this exercise and for granting equivalence is that doing so "brings benefits to both the EU and third-country financial markets". And that it does so by "reducing or eliminating overlaps in compliance; inferring that certain services, products or activities of firms in that third country are acceptable for regulatory purposes in the EU; and enabling a less burdensome prudential regime to be applied to EU financial institutions' exposures to an equivalent third country", as stated in "EU equivalence decisions in financial services policy" SWD(2017) 102 final, p.5.

34. *EC, "European Commission adopts equivalence decisions for CCPs and trading venues in ten non-EU jurisdictions" (2016)*.

35. The complete list as at 19 September 2016 can be found in *EC, "Recognition of Non-EU Financial Frameworks (Equivalence Decisions)" (2016)*.

36. As happened recently, for example, in relation to bank executive compensation. See *J. Armour, D. Awrey, P. Davies, L. Enriques, J.N. Gordon, C. Mayer and J. Payne, Principles of Financial Regulation (Oxford: Oxford University Press, 2016), Ch.17* quoted in J. Armour, "Brexit and financial services" (2017) 33 Oxford Review of Economic Policy S61, S64.

37. On revocability and the differences between equivalence and passporting being a privilege and a right respectively, see *G. Finch and J. Glover, "Goodbye Passport, Hello Equivalence? Brexit Banks Lower Sights" (13 January 2017), Bloomberg* available at:

https://www.bloomberg.com/news/articles/2017-01-13/goodbye-passport-hello-equivalence-brexit-banks-lower-sights [Accessed 2 November 2017]. This article also reports that "[e]quivalence doesn't carry any of the permanence of other regimes on the basis that it's ultimately a political decision", according to Simon Lewis, CEO of the Association for Financial Markets in Europe (12 January 2017).

38. As observed above, the countries with the most areas of equivalency have secured fewer than half of those possible, 16 out of 39.

39. To reiterate some examples of present exclusions: "the payments sector, mortgage and credit industries have no equivalence provisions in the relevant European legislation. For these sectors of the financial services industry, regulatory equivalence under the current European regime will not provide any solutions"— *Norton Rose Fulbright, "Examining Regulatory Equivalence" (12 January 2017), p.16*.

40. For examples of the length of time in the run-up to an equivalency finding, see *Finch and Glover, "Goodbye Passport, Hello Equivalence?" (2017)*. This article, citing Jonathan Hill (the EU's former financial-services chief) describes the instance of a "tiny subset of the whole financial services sector landscape", where each side "wanted to conclude it quickly" and it nevertheless took four years to reach registration as an equivalent area for a single country. As another example, see *"Brexit sector briefing: Financial services and banking" (6 February 2017), Ashurst* available at https://www.ashurst.com/en/news-and-insights/legal-updates/brexit-sector-briefing--financial-services-and-banking/ [Accessed 2 November 2017]: "It took the EU several years to grant clearing equivalence to central counterparties registered with the US Commodity Futures Trading Commission under EMIR". This publication also observes that there is currently a pending backlog of applications for third-country equivalence.

41. "[I]n accordance with Article 47(1)"—MiFIR art.49.

42. MiFIR art.49(a) –(c).

43. MiFIR art.49(d).

44. See discussion on the political aspects of the problem in L. Quaglia, "The Politics of 'Third Country Equivalence' in Post-crisis Financial Services Regulation in the European Union" (2015) 38 Western European Politics 38.

45. Armour, "Brexit and financial services" (2017) 33 Oxford Review of Economic Policy S61, S63: "an important item on the UK's agenda should be seeking to persuade the Commission to begin its assessments of relevant aspects of the UK financial regulation regime at the time of triggering Article 50. This would give enough time for a smooth transition: if the process does not commence until after exit, this would leave a significant hiatus in wholesale market provision".

46. Directive 2009/138 on the taking-up and pursuit of the business of Insurance and Reinsurance [2009] OJ L335/1.

47. *V. Scarpetta and S. Booth, How the UK's Financial Services Sector Can Continue Thriving after Brexit (17 October 2016)* available at: https://openeurope.org.uk/intelligence/britain-and-the-eu/how-the-uks-financial-services-sector-can-continue-thriving-after-brexit/ [Accessed 2 November 2017].

48. "Even if UK/EU negotiations include specific provisions on equivalence, from a legal standpoint, the Commission may suspend beginning its formal assessment of equivalence until the UK has left the EU"— *Norton Rose Fulbright, "Examining Regulatory Equivalence" (2017), p.16*.

49. The Citigroup analyst Andrew Coombs stated that this would likely be the UK's aim—in a report dated 11 January 2017 quoted in *Finch and Glover, "Goodbye Passport, Hello Equivalence?" (2017)*.

50. Directive 2014/65 on markets in financial instruments and amending Directive 2002/92 and Directive 2011/61 [2014] OJ L173/349.

51. Barney Reynolds, a financial services lawyer with Shearman & Sterling, states that MiFID II "brings the possibility of equivalence 'for the entirety, pretty much' of the investment business" quoted in *H. Jones and A. MacAskill, "Citi says EU 'Equivalence' Regime No Answer to Brexit Banking Question", Reuters* available at: http://uk.reuters.com/article/us-britain-eu-banks-idUKKBN16T291 [Accessed 2 November 2017].